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In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, PETITIONER

v.

XEROX CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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1. a. Respondent claims (Br. in Opp. 11) that the petition should be denied because there are no conflicting decisions. But we did not argue that the petition should be granted because of a conflict within the circuits. Instead, as this Court has often concluded in similar contexts, the petition should be granted because the Federal Circuit is a court of nationwide jurisdiction and its decision in this case presents questions of substantial fiscal and administrative importance. Pet. 15. See, *e.g.*, *United States* v. *Hill*, 113 S. Ct. 941, 945 (1993); *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132, 138 (1989). [1]

[1] Respondent errs in claiming (Br. in Opp. 11) that *Snap-on Tools* v. *United States*, 26 F.3d 137 (Fed. Cir. 1994), is relevant to the present case. *Snap-on Tools* concerned the entirely distinct question whether dividends paid by a foreign corporation during the first 60 days of the year are to be treated as if paid from the accumulated profits of that

b. Respondent contends that the absence of other pending litigation on the questions presented in this case is "compelling evidence" (Br. in Opp. 13) that the decision of the court of appeals has only a limited significance. The fact that respondent took a uniquely aggressive stance on this tax issue does not mean that the decision in respondent's favor lacks administrative importance. To the contrary, as the petition notes (Pet. 22):

> The foreign tax credits claimed by United States taxpayers with respect to the "foreign income taxes" paid by their United Kingdom subsidiaries exceeded $2.24 billion [in 1990 alone]. Even a modest increase or realignment of foreign tax credits available to these United States taxpayers could yield huge revenue consequences. Moreover, the statute of limitations for amended returns with respect to foreign tax credit claims is ten years from the date that the taxpayer's return was filed. 26 U.S.C. 6511(d)(3). The decision in this case thus threatens a major impact on revenue not only for the future, but also for a significant period into the past.

Because the decision in this case "has changed the timing of a United States parent's entitlement to foreign tax credits for advance corporation tax," international tax advisors have counseled corporations to give "consideration * * * to amending United States tax returns and adjusting earnings and profits and foreign taxes of United Kingdom corporations." D. Marks, *Advance Corporation Tax*, The Tax Journal 5, 6 (Apr. 20, 1995). As

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corporation for the prior year. The issues addressed in that case have no relationship to the questions presented in this case. Respondent is indulging in hyperbole in suggesting that the decision not to seek further review in *Snap-on Tools* is "dramatic evidence that the government itself does not consider" the different issues involved in the present case to be "of any real importance" (Br. in Opp. 12).

these advisors note, the decision in this case permits corporations to engage in tax planning that reduces their world-wide tax exposure simply by adjusting "which companies in the group should account for the [advance corporation tax] on dividend payments." *Id.* at 6. [2]

Respondent errs in suggesting (Br. in Opp. 12) that the decision in this case applies only when a United Kingdom subsidiary surrenders the right to offset the payment of "advance corporation tax" against corporation tax liability to a second-tier subsidiary. The court of appeals held that the "advance" tax "is a separate tax, and is not properly viewed as a prepayment or interim credit or estimated tax of mainstream corporate tax" (Pet. App. 31a). The court concluded that the advance corporation tax is "fixed," and the credit is to be given, "in the year it is paid or accrued in the United Kingdom" (*id.* at 31a-32a). The holding and rationale of the decision in this case thus purport to apply to any case where the "advance corporation" tax is *either* deferred *or* surrendered for application against "corporation" tax liability in a later year.

As a result, taxpayers who defer or surrender their setoff right have an option to follow either the Federal Circuit's decision or the Treasury's Technical Explanation in computing their foreign tax credits. Those who receive a greater benefit from the approach of the Federal Circuit will recompute their credits and enforce their claim in a refund suit within the Federal Circuit. Those who receive a greater benefit under the Technical Explanation will rely on the Treasury's published interpretation. Evenhanded enforcement of the foreign tax credit provisions is thus fully compromised.

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[2] The Treasury Department informs us that taxpayers are following the recommendation of these advisors and are recomputing their credits in order to file refund claims based on the decision in this case.

2. Respondent's extensive efforts to defend the erroneous decision of the court of appeals do nothing to detract from the need for this Court's further review.

a. Respondent contends that the Treasury's interpretation defeats the Treaty's goal of reducing "double taxation on U.K. corporate dividend distributions to U.S. shareholders" (Br. in Opp. 18). Neither respondent nor the court of appeals, however, explains how the Treasury's interpretation results in double taxation of corporate dividends distributed to United States shareholders. As we explain in the petition, the Treasury's interpretation does not result in double taxation. Pet. 19.

Respondent nonetheless contends that the Treasury's interpretation is "inequitable" because respondent's subsidiary was "forced" to surrender its setoff right under United Kingdom law so that the subsidiary could "use efficiently" its own United Kingdom foreign tax credits (Br. in Opp. 8, 15). What respondent is euphemistically describing is the fact that, under *United Kingdom law*, its subsidiary simply had more credits against its United Kingdom tax obligation than it needed. There is, of course, no precedent for the suggestion that United States law should be interpreted in such a way that respondent obtains maximum benefit not only of its United States tax credits but also of the tax credits independently available to it under *foreign* law. The Treasury's position is not, as respondent puts it, "inequitable" (*id.* at 15) simply because it does not enable respondent to minimize its total, world-wide tax payments. Under the Treasury's interpretation, respondent is entitled to obtain the full benefit of the United States foreign tax credit at the time that the "advance" payment is applied against the "corporation" tax liability. See Pet. 19.

b. Respondent belatedly acknowledges (Br. in Opp. 18) that the timing of the foreign tax credit for payments

of the advance corporation tax is to be determined under United States law and not under the Treaty itself. See Pet. 15-17; Br. in Opp. 18. Respondent errs, however, in stating (*ibid.*) that the court of appeals also acknowledged that fact. Instead, the court of appeals erroneously concluded that the "advance" tax was a "separate" tax and that the credit for that tax became "fixed" under the Treaty and "vested in Xerox when the tax and dividends were paid" (Pet. App. 31a, 32a).

c. The Internal Revenue Code does not directly and precisely answer whether the foreign tax credit for the advance corporation tax is to be granted under United States law at the time that the "advance" tax is paid or when that payment is later applied against the ultimate corporation tax liability. The Technical Explanation and Revenue Procedure 80-18 were adopted by the Treasury to interpret how the general foreign tax credit provisions of the Code apply in this discrete foreign tax context.[3]

Section 902 of the Internal Revenue Code allows a foreign tax credit only for foreign taxes paid on the "ac-

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[3] Respondent mistakenly refers to the Technical Explanation, Revenue Procedure 80-18 and the Competent Authority Agreement as "post treaty interpretations" (Br. in Opp. 22). The first two were issued contemporaneously with the adoption and ratification of the Treaty. The Technical Explanation was presented to the Senate at the time of its hearings (Pet. App. 17a) and the Senate ratified the Treaty with full knowledge of the Treasury's interpretation (Pet. 18-19 & n. 16). The Revenue Procedure was issued on the date the Treaty went into force (Pet. App. 21a) and is also a contemporaneous interpretation of the agency. While the Competent Authority Agreement is a "post treaty" record, Article 25 of the Treaty provides that the competent authorities may "resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the" Treaty (Pet. App. 58a-59a). The Competent Authority agreement is therefore entitled to dispositive weight. See *Factor* v. *Laubenheimer*, 290 U.S. 276, 294-295 (1933).

cumulated profits" of a foreign subsidiary. *United States* v. *Goodyear Tire & Rubber Co.*, 493 U.S. 132, 138-139 (1989). If the advance corporation tax is not applied to the foreign subsidiary's corporation tax liability in the year it is paid, it effectively becomes an additional income tax on the "accumulated profits" of the foreign subsidiary for that year. The Treasury therefore concluded that a provisional credit should be allowed under United States law for advance corporation tax in the year it is paid. When the "advance" tax is thereafter applied to corporation tax liability for a different year, or is surrendered for application against a subsidiary's corporation tax liability, however, that payment becomes a charge against the "accumulated profits" of the later year. The Treasury therefore reasonably concluded that United States law provides a permanent credit for the "advance" tax in the year it is applied as payment of the taxes owed for the "accumulated profits" of the foreign subsidiary.

Under Section 905(c) of the Code, when a "foreign income tax" paid by a foreign subsidiary results in a foreign tax credit for its United States parent, and the foreign tax of the subsidiary is later adjusted or refunded, the United States income tax liability of the parent is to be redetermined. The Technical Explanation explains that, when the "advance corporation tax" is used to satisfy the "corporation tax" in a different year, "the offset will be viewed as a refund of the [advance corporation tax] initially allowed as a credit and as a tax paid in respect of the year for which the [advance corporation tax] is applied as an offset" (Pet. App. 82a).[4] While

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[4] Respondent suggests (Br. in Opp. 20-21) that this interpretation of Section 905(c) is inconsistent with Treasury Regulation Section 1.901-2(e)(4). That regulation concerns the situation where the liability

United States law, rather than United Kingdom law, controls the timing of the tax credit (see Pet. 16-17), it should be noted that United Kingdom law *also* specifies that the second-tier subsidiary to whom the "advance" payment is surrendered "shall be treated * * * as having paid an amount of advance corporation tax equal to the surrendered amount." Finance Act of 1972, § 92(2)(a), quoted at Br. in Opp. App. 8a.[5]

The Treasury's interpretation of how the general foreign tax credit provisions of the Code apply in this discrete foreign tax setting is entitled to substantial deference. *Commissioner* v. *Portland Cement Co. of Utah*,

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for a foreign income tax may be "reduced by the amount of the taxpayer's liability for a different levy (the 'second levy')" (*ibid.*). It gives as an example of its scope the facts of Example 5 of Treasury Regulations Section 1.903-1(b)(3). That Example describes the facts of *Helvering* v. *Queen Insurance Co.*, 115 F.2d 341 (2d Cir. 1940), cert. denied, 312 U.S. 706 (1941). The regulation that respondent cites, and the *Queen Insurance* decision that the regulation incorporates by example, are not relevant to the issues presented in this case for the reasons already explained in the Petition. See Pet. 20-21 n. 17. This case does not concern the *amount* of the foreign income tax that has been paid when an income tax is reduced by some other *non*-income tax levy; it instead concerns the situation where the Treaty defines *both* levies to be foreign "income" taxes but leaves to United States law the determination of the proper *timing* of the credit that must be allocated between them.

[5] Respondent asserts that the Treasury's position is wrong because "section 905(c) applies to actual refunds of foreign tax and not to alleged or deemed refunds" (Br. in Opp. 21). Neither respondent nor the court of appeals (Pet. App. 30a-31a) cites any authority in support of that proposition. Contrary to respondent's unsupported contention, the statute does not state that it applies only to "actual" refunds (Br. in Opp. 21). Instead, it refers simply to "adjustments" and "refunds," and it is obvious that an adjustment or refund may be made by allowing a "credit" against a different tax obligation as well as by remitting an "actual" payment to the taxpayer. See 26 U.S.C. 6402(a).

450 U.S. 156, 169 (1981). "The choice among reasonable interpretations is for the Commissioner, not the courts." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 488 (1979). The interpretation adopted by the Treasury is "reasonable" (*ibid.*) and should not have been rejected by the court of appeals.

3. Before arguing that the court of appeals correctly relied on the post-trial affidavits of individuals who were not competent authorities to interpret the Treaty (Br. in Opp. 26-30), respondent first inconsistently claims that the court of appeals did *not* rely on those affidavits (*id.* at 25). Even a cursory reading of the opinion of the court of appeals, however, shows that the court in fact relied extensively on the affidavits. The court quoted the affidavits at length in describing what it called "The Negotiation History" of the Treaty (Pet. App. 15a-17a). The court also relied extensively on the post-trial affidavits in rejecting the Treasury's Technical Explanation of the Treaty (*id.* at 20a-21a). Indeed, the court's central premise—that the "advance" tax is a "separate" tax, the credit for which is "fixed" under the Treaty at the time the "advance" tax is paid (*id.* at 23a, 31a)—was emphatically based by the court on its acceptance of the statement in the post-trial affidavits that the "*foreign tax credit had to be currently creditable*" under the Treaty itself (*id* at 16a; emphasis by court). The court plainly and directly relied on the post-trial affidavits in describing what the court stated was an "extremely one-sided record" in this case (*id.* at 21a).

Respondent errs in contending (Br. in Opp. 26) that the post-trial affidavits became a proper part of the evidentiary "record" in this case when they were submitted by respondent in connection with its new trial motion five years after the conclusion of the trial. As the petition explains (Pet. 26 & n.23), post-trial affidavits are

hearsay and, when offered in connection with a new trial motion, may be considered only in evaluating that motion; they may not be considered in evaluating the merits of the underlying decision.[6]

Respondent further contends (Br. in Opp. 28-29) that the error of the court of appeals in relying on the ex parte, post-trial affidavits should be ignored because *other* "competent evidence" supports at least some of the statements made in the affidavits. The other "evidence" to which respondent refers is correspondence between the United Kingdom Inland Revenue and respondent's counsel that occurred several years *after* the trial (Br. in Opp. App. 21a-26a). These post-trial letters, like the post-trial affidavits, were submitted by respondent in connection with its motion for a new trial. Like the post-trial affidavits, the post-trial letters are not competent authority agreements and are not "competent evidence" on the merits of this case. See Pet. 28 n.25. Respondent's contrary view ignores that "evidence" is to be submitted and weighed at trial, not on appeal.

Moreover, the letters state only that the Inland Revenue has "no reason to dissent from" *one* of the many factual assertions made in the post-trial affidavits. What the letters do not "dissent from" is the statement that the Treasury's Technical Explanation was not presented by the United Kingdom government on the floor of the

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[6] Respondent errs in stating (Br. in Opp. 27) that, by not objecting to inclusion of the post-trial affidavits in the joint appendix on appeal, the government waived its objection. Not surprisingly, respondent cites no plausibly relevant authority for that proposition. The affidavits were properly included in the joint appendix because *if* respondent had reasserted its new trial claim on appeal the affidavits *could* have been relevant to that issue. Respondent chose not to seek a new trial on appeal, however, and the court's reliance on the post-trial, ex parte affidavits in its decision on the merits was improper.

House of Commons (Br. in Opp. App. 26a). The letters do not, as respondent misleadingly suggests, "confirm" the entire bulk of the lengthy post-trial affidavits (Br. in Opp. 29). In particular, they do not "confirm" the portions of the affidavits that offer personal interpretations of the Treaty, on which the court of appeals emphatically relied. See page 8, *supra*.

Instead, the post-trial letters reaffirm the statement in the Competent Authority agreement that "the timing of the credit is to be determined as a matter of U.S. law" and that the Treaty itself does not fix the timing of the credit (Pet. App. 61a; see Br. in Opp. App. 24a, 26a). Despite this bilateral international agreement, respondent procured and submitted private, ex parte affidavits *five years after the trial* in an effort to show that the Treaty partners intended the credit to be fixed permanently in the year it is paid in the United Kingdom. Those post-trial affidavits conflict with the interpretation of the Treaty adopted by the "competent authorities." By relying upon the post-trial, ex parte affidavits as if they were part of the evidentiary record of this case, the court of appeals allowed unexamined private recollections, rather than the considered, public views of governments, to adjust the affairs of Nations.

As the facts of this case itself reveal, the evidentiary approach of the court of appeals threatens to create a persistent irritant in the sensitive process of bilateral administration of treaty agreements. The Departments that administer our Nation's treaties need guidance from this Court concerning the extent to which the unofficial recollections of former employees are relevant and admissible in cases involving treaty construction.

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For the reasons stated herein and in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

AUGUST 1995